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Regions Financial Corp. (RF)

Q4 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Regions Financial Corporation's Quarterly Earnings Call. My name is Angie, and I'll be your operator for today's call. I would like to remind everyone that all participants' phone lines have been placed on listen-only. At the end of the call, there will be a question-and-answer session. [Operator Instructions]

I would now like to turn the call over to Dana Nolan to begin.

Dana W. Nolan

Executive Vice President-Head of Investor Relations, Regions Financial Corp.

Thank you, Angie. Welcome to Regions' Fourth Quarter 2018 Earnings Conference Call. John Turner will provide highlights of our full year financial performance, and David Turner will take you through an overview of the quarter. A copy of the slide presentation as well as our earnings release and earnings supplement are available under the Investor Relations section of regions.com.

Our forward-looking statements, disclosure and non-GAAP reconciliation are included in the appendix of today's presentation and within our SEC filings. These cover our presentation materials, prepared comments, as well as the question-and-answer segment of today's call.

With that, I will turn the call over to John.

John M. Turner, Jr.

President, Chief Executive Officer & Director, Regions Financial Corp.

Thank you, Dana. Good morning and thank you for joining our call today. Let me begin by saying, we're very pleased with our fourth quarter and full year 2018 results. We reported record full year earnings from continuing operations of $1.5 billion reflecting an increase of 28% compared to the prior year. Importantly, we grew loans, net interest income, non-interest income, and households. We delivered positive operating leverage and markedly improved efficiency. Of note, adjusted pre-tax, pre-provision income increased to its highest level in over a decade. David will cover the details in a moment. And I'm very proud to announce we effectively achieved all of our 2018 targets as well as our long term targets laid out at Investor Day in 2015. We achieved these targets despite a market backdrop that was significantly different than we anticipated. It's important to note our financial accomplishments took place against a backdrop of substantial transformation for the company.

In 2018, we successfully navigated significant leadership changes and undertook one of the most significant organizational realignments in the company's history. With most of the organizational changes behind us, we've intensified our focus on building a culture of continuous improvement, improvements which reflect our efforts to make banking easier for our customers and associates, accelerate revenue growth, and drive greater efficiency and effectiveness.

These efforts include investments in technology where we've expanded the use of artificial intelligence and machine learning. As of year-end, we rolled out Zelle giving our customers industry leading person-to-person payments capabilities. We also rolled out our new e-signature platform completing our first end-to-end, fully digital consumer loan closings.

With respect to market's recent volatility, it's only heightened our focus on the fundamentals of our business and things that we can control providing customers with quality advice, guidance and financial solutions while maintaining appropriate risk adjusted returns and unwavering credit discipline. On that note, recent credit quality continues to reflect a relatively strong economy and is performing within our stated risk appetite.

Total non-performing criticized and troubled debt restructuring loans continued to decline in the fourth quarter, while net charge-offs increased. The increase in net charge-offs are driven by higher consumer net charge-offs attributable to fourth quarter seasonality, continued normalization, and an expected increase associated with growth in consumer indirect categories.

As we talk to our customers, they feel good about their businesses and remain encouraged about their outlook for 2019. On the retail side, consumer sentiment is also positive because unemployment remains low and wages continue to increase. As we enter 2019 and our next three-year strategic planning period, our goal is to generate consistent and sustainable long term performance. We achieved meaningful progress over the past year as we work to create a more efficient and effective organization. We have a variety of work streams still in progress and believe we're only beginning to realize the benefits that will ultimately be derived from our efforts.

With that, I'll now turn it over to David.

David J. Turner, Jr.

Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

Thank you, John, and good morning. Let's begin on slide 3 with average loans. Adjusted average loans increased 1% over the prior quarter driven by broad based growth across consumer and business lending portfolios. On a full year basis, adjusted average loan growth was 2% in line with our expectations of low-single digits. Once again, all three areas within our Corporate Banking group which include large corporate, middle market commercial, and real estate experienced broad based loan growth across our geographic markets.

Total average loan growth was led by C&I where well diversified growth was driven by our specialized lending, government institutional businesses, and REIT lending portfolios. In addition, the investor real estate portfolio grew 3% driven by growth in term real estate lending primarily within the office and industrial property types. Average owner occupied commercial real estate loans declined modestly.

There's been a lot of industry focus on leverage lending of late. We defined leverage lending primarily as commitments exceeding $10 million where the leverage as a multiple of EBITDA or cash flow exceeds three times for senior debt and four times for total debt. These credits are subject to enhanced underwriting and monitoring standards. The portfolio is well diversified and aligned to our specialized industry verticals with dedicated teams of bankers, underwriters, credit officers, and enterprise valuation specialists. During the fourth quarter these outstanding balances declined modestly.

With respect to consumer lending, loan growth remained consistent across most categories led by indirect-other consumer as well as increases in residential mortgage and consumer credit card lending. Consistent with forecasted GDP growth, we expect to grow full year 2019 adjusted average loans in the low-single digits.

So, let's move on to deposits. We continue to execute a deliberate strategy to optimize our deposit base by focusing on growing low cost consumer and relationship based business services deposits while reducing certain higher cost retail brokered and trust collateralized suite deposits. Total average deposits declined less than 1% compared to the third quarter. However, ending balances increased $1.2 billion or 1% as we've experienced success growing interest bearing checking, money market, and time deposit balances.

Importantly, our bankers continue to grow new Consumer households, Wealth relationships, and Corporate customers. On a full year basis, average deposits excluding retail brokered and wealth institutional services deposits, decreased less than 1%, in line with our expectation of relatively stable. Our large stable deposit base, continues to provide a significant funding advantage, cumulative deposit betas through the current rising rate cycle remain low at 18%. Fourth quarter deposit betas increased modestly to 39%. This supports a low cumulative overall funding beta of 22%.

Our large retail deposit franchise differentiates us in the marketplace and positions us to maintain lower deposit and total funding costs relative to peers. So let's see how this impacted our results. Net interest income increased 2% over the prior quarter and net interest margin increased 5 basis points to 3.55%. On a full-year basis, adjusted net interest income grew 5.4% in line with our expectation of 5% to 6%. Both net interest income and margin benefited from higher market interest rates, partially offset by higher funding costs. Net interest income also benefited from higher average loan balances.

So let's take a look at fee revenue. Adjusted non-interest income decreased 7% from the third quarter. Service charges increased 3% and capital markets income increased 11%. The increase in capital markets income was primarily attributable to higher loan syndication income, fees generated from the placement of permanent financing for real estate customers, and merger and acquisition advisory services partially offset by lower customers swap income. Swap income declined approximately $6 million in the quarter, entirely due to negative market value adjustments at year-end.

Offsetting these increases, market volatility in the fourth quarter also drove significant valuation declines in assets held for employee benefits and negatively impacted bank-owned life insurance income. Revenue associated with market value adjustments on total employee benefit assets decreased $22 million, and bank-owned life insurance income decreased $6 million. Mortgage income decreased 6%, primarily due to seasonally lower production and sales revenue, partially offset by higher hedging and valuation adjustments on residential mortgage servicing rights and increased servicing income.

Continuing with our strategy to leverage our mortgage servicing advantage and capacity, we completed the purchase of rights to service another $2.7 billion of residential mortgage loans during the fourth quarter.

The decrease in other non-interest income was primarily attributable to a net $3 million decline in the value of certain equity investments in the fourth quarter compared to a net $8 million increase in the third quarter. In addition, $4 million of third quarter leverage lease termination gains did not repeat. On a full year basis, adjusted non-interesting income grew 3.8%, excluding the impact of fourth quarter market value declines on employee benefit assets, bank-owned life insurance and customer swaps, full year adjusted non-interest income grew 5.2% in line with our expectation of 4.5% to 5.5%.

Let's take a look at expenses. On an adjusted basis, non-interest expense decreased 1% compared to the third quarter. Excluding the impact of severance charges, salaries and benefits decreased 1% reflecting the benefit of staffing reductions. This decrease was partially offset by one additional workday in the fourth quarter and an increase in incentive-based compensation.

Professional fees decreased 16% attributable to lower legal expenses, and FDIC insurance assessments decreased 36% reflecting the discontinuation of the FDIC surcharge. Partially offsetting these declines, occupancy expense increased 5%, attributable to storm-related charges associated with Hurricane Michael.

On a full year basis, adjusted non-interest expense increased less than 1% in line with our expectation of relatively stable. Excluding the benefit from market value adjustments on employee benefit assets and a discontinuation of the FDIC surcharge, the increase in adjusted non-interest expense remains less than 1%.

We achieved our efficiency target with a full year adjusted ratio of 59.3%. The adjusted efficiency ratio for the fourth quarter was 58.1% providing good momentum for 2019 and beyond. We expect full year 2019 adjusted expenses to remain relatively stable with adjusted 2018 expenses.

Additionally, we generated adjusted full year of positive operating leverage of 3.6% in line with our expectation of 3.5% to 4.5%. The fourth quarter effective tax rate was approximately 17% and reflects favorable retrospective tax accounting method changes and adjustments for certain state tax matters.

The full year effective tax rate was approximately 20% in line with our expectation of approximately 21%. We do expect the full year 2019 effective tax rate to be in the 20% to 22% range. Let's move onto asset quality. As John noted, overall asset quality continues to perform in line with our expectations. Total non-performing loans excluding loans held for sale increased to 0.60% of loans outstanding, the lowest level in over 10 years. Business service is criticized and troubled debt restructured loans decreased 5% and 14% respectively.

Net charge-offs increased 6 basis points to 0.46% of average loans driven primarily by seasonality within our consumer portfolios, normalization of consumer charge-offs and the growth in indirect consumer loans. The provision for loan losses approximated net charge-offs and the resulting allowance totaled 1.01% of total loans and 169% of total nonaccrual loans. On a full year basis, adjusted net charge-offs total 39 basis points in line with our expectation of 35 basis points to 50 basis points. Given where we are in the cycle and the continued normalization of certain credit metrics, we expect full year 2019 net charge-offs to be in the 40 basis points to 50 basis points range.

Let me give you some comments on capital and liquidity. During the quarter, the company repurchased 22 million shares of common stock for a total of $370 million and declared $144 million in dividends to common shareholders. On October 24, 2018, our accelerated share repurchase agreement transaction closed and final settlement resulted in an additional delivery of 8.75 million shares of common stock on October 29. This brought the total shares repurchased under the ASR to $37.8 million. The loan-to-deposit ratio at the end of the quarter was 88%. And as of quarter end, the company remained fully compliant with the liquidity coverage ratio rule.

Slide 11 reflects our 2018 performance against our targets. And we've also provided you a select group of full year 2019 expectations that were previously mentioned throughout the presentation. We will provide additional 2019 and long-term expectations at our Investor Day next month.

So, in summary, we're very pleased with our 2018 financial results. We generated record earnings, grew loans, checking accounts, households, wealth relationships; and corporate customers. We also generated almost 4% of adjusted positive operating leverage and improved our adjusted efficiency ratio by 210 basis points. As John mentioned, these accomplishments were made while our company has undergone significant change, changes that have positioned us well for 2019 and beyond.

With that, we're happy to take your questions but do ask that you limit them to one primary and one follow-up question. We will now open the line for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for questions. [Operator Instructions] Your first question is from the line of Jennifer Nimba with Star Trust (sic) [Jennifer Demba with SunTrust] (00:18:34).

Q

Hey, guys. It's actually [ph] Steve (00:18:39) on for Jennifer.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Hello, [ph] Steve (00:18:40).

Q

I just wanted to talk to you guys about your asset sensitivity. Any plans to hedge away any of this, it seems that that's going to be pausing and then the forward curve is actually looking for a decrease in 2020 right now?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

So, Steve, we've – it's David. We continue to look at our asset sensitivity and think about what the rate environment would be. We still are fairly asset sensitive; up a 100 is a little over $100 million over a 12-month period of time. Now, we have put some hedges on as we've discussed in previous quarters that we have forward starting to help us manage what we think the rate environment might look like out a couple of years from here or a year and change from here. Such that, we get to a point where we're getting more neutral at that time, now we still think the Fed is going to be data dependent in terms of what they may do on raising rates in the short term, so we think still being asset sensitive at the moment is the right place for us to be. And so, we're gauging how much of that we want to take off in the future.

Q

Perfect. Thanks. And then, as far as pay-downs in the fourth quarter, how do these compare to the first three quarters of 2018? Thanks.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yeah. We didn't see nearly the pay-down activity that we experienced let's say in the first two quarters which were the most active. I think it was more of a normal quarter would be the way I would characterize it.

Q

Perfect. Thanks, guys.

Operator: And your next question is from the line of John McDonald with Bernstein.

John Eamon McDonald
Analyst, Sanford C. Bernstein & Co. LLC

Q

Hi. Good morning, guys.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning, John.

John Eamon McDonald
Analyst, Sanford C. Bernstein & Co. LLC

Q

Wanted to follow up on that loan growth. We saw the loan growth pick up for the industry in the fourth quarter. A number of banks have talked about that kind of accelerating. So, just kind of wondering, did you see this fourth quarter loan growth demand pick-up? As you mentioned, the pay-downs are a little bit better. And I guess my follow-up, I'll ask that at the same time, what kind of pipeline momentum do you enter 2019 with and could you see loan growth be a little stronger for Regions in 2019 versus 2018? What are the puts and takes that you have in particular...?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yeah.

John Eamon McDonald
Analyst, Sanford C. Bernstein & Co. LLC

Q

...if you look at 2019? Thanks.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yeah. We ended the year with a really very strong quarter particularly on the wholesale side of the business. And as a result, you saw an increase in ending loan balances because quite a bit of the activity was towards the end of the year. The loan growth was really well-balanced, as we referred to earlier, across most of our segments within the industries. We grew our energy, our power utilities groups, technology and defense, financial services, our government institutional banking groups. So a number of areas where we have specialized expertise across both our corporate and our commercial banking platforms grew during the quarter. Within real estate, we grew our term lending portfolio which has now been an important strategic initiative of ours. We're beginning to see much better balance between term lending production and construction originations. And within that category of term lending, we grew office and we grew industrial, broadly across our geographic footprint.

So it was a good quarter, production was up significantly over the prior quarters. As a result of that, we ended the year where the pipeline is a little softer than we began the fourth quarter with. We're guiding toward low single digit loan growth again, given that we'll have puts and takes within the portfolio. We continue to focus on portfolio optimization, on risk adjusted returns and improving the quality of the portfolio. And so we don't expect, John, to grow much more than GDP plus possibly a little. That's our plan. And if we do that, we can achieve all the financial objectives that we set out.

John Eamon McDonald
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. Thank you.

Operator: And your next question is from Matt O'Connor with Deutsche Bank.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.

Q

Hi. I was just wondering on the service charges, you had real nice growth year-over-year. And remind us [ph] does it have any (00:23:09) price increases or was the year-ago level depressed or anything?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Hey, Matt. It's David. No. It's really not price increases, service charges have a tendency to follow our account growth. And our focus on growing core checking accounts has really been a hallmark of our franchise, and we continue to see that. And as a result, the service charges have responded favorably.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Consumer checking growth, [ph] now it's (00:23:37) up about 1.3%. And as David says with that comes, service charge activity, debit card usage and other things, all of which have been very positive.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. And then just [ph] hopefully (00:23:49) on credit quality, the charge-offs did pick up a little bit I think some of it was coming from home equity. Is there any noise from recent hurricanes that might be distorting that?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

I'll let Barb answer that.

Barbara I. Godin
Senior Executive Vice President & Chief Credit Officer, Regions Financial Corp.

A

Yeah. No, there's very little if anything that came from the hurricanes this time which we were blessed on. The charge-offs that we saw, the increase between this quarter and last quarter quite frankly was expected given the seasonality in the consumer portfolio and reflects our focus in the past several quarters on some of the higher yielding products that we have in consumer. We're getting appropriately paid for the risk. So again, we feel pretty good about the credit quality.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thank you.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Thank you.

Operator: [Operator Instructions] Your next question is from Erika Najarian with Bank of America.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Hi. Good morning.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning, Erika.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Morning.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

I know you're going to provide us more detail in a month and a half or so at your Investor Day, but I'm wondering as we think about our two-year earnings outlook for Regions, should we look forward to continued efficiency improvement? And can that efficiency improvement occur even if the revenue environment becomes more challenging than budgeted?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Hey, Erika, we've done a pretty good job of managing our expense base, as well as growing revenue evidenced through our simplifying road continuous improvement process. That is a journey it's not a program, where we continue to look at every aspect of our business in terms of how we can improve every single day. We have a number of projects on the table today that we will continue to benefit from. Clearly, our goal is to improve our efficiency ratio. We had talked about over time getting into the mid-50s. We're going to talk a little bit more about that at our Investor Day as you mentioned.

But clearly, there's aspects of revenue growth and expense management in that. As revenue becomes more challenge, we have to continue to look for ways to get to that efficiency ratio. We feel pretty confident we can get there. And so, from a revenue standpoint, if it becomes more challenging, we'll do something else on the expense side.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Hey, Erika, this is John. I'll just reiterate that, that commitment to continually improving our efficiency ratio, we think it's fundamental to our long term performance and to building a consistently performing sustainable bank and that's our intention. So, we are very committed to that.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Thank you for that. And my follow-up question is again, as the market seems to be pricing in a Fed on hold for some time. How should we think about the margin trajectory for – sorry for 2019 under that scenario? And also, how should we think about the delay in terms of repricing or how long do deposits reprice after the Fed pauses?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Yeah. I think you'll continue to see deposit cost increase, a little lag effect as things go through for the year. We think and – for the quarter, this quarter coming up, we could be relatively stable given everything that's going on. We do have tailwind still from repricing of fixed rate assets, loans and securities, it'll be coming through this year about $12 billion repricing. Those repricings benefit us in the, call it 30 to 50 basis point range maybe a little better today as we continue to see the 10-year move up a bit.

So, from a pause standpoint, we still benefit from our – what we believe is our competitive advantage. And that's our very loyal customer deposit base, two-thirds of which is retail. And if you look at our deposit beta and our total funding beta, continues to be below peers. So we think that gives us an opportunity to continue to outperform through 2019 and beyond.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Great. Thank you.

Operator: And your next question is from Saul Martinez with UBS.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning, Saul. We lost him. Okay.

Saul Martinez
Analyst, UBS Securities LLC

Q

Can you hear me?

Operator: Saul, your line...

Saul Martinez
Analyst, UBS Securities LLC

Q

...hear me? Hello. Hello?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

I can now. Yeah. We can hear you now.

Saul Martinez
Analyst, UBS Securities LLC

Q

I need to learn how to use this fancy technology called the telephone. So, I wanted to ask about fees. How do we think about what the right jump-off point is for the fee line? Obviously, you had a lot of moving parts in there with the market volatility, the $22 million that you called out, $3 million of equity investments. Is it as simple as just adding those back in? Because you've kind of been in sort of that $500 million to $510 million run rate in recent quarters. I mean is that – is it – should we just kind of add back those items and is that a reasonable way to think about it looking on a go forward basis?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Yeah. Saul, I do you think those are things that adding those back – we're trying to give you the information where you could do that. Our continued growth in NII – NIR will come through if you just look at our core lines, our service charge line continuing to grow along with the account growth that we have. Card and ATM fees is the same way. We continue to grow cards and account. More transactions are moving to that mode of payment. So the interchange should continue to improve there as well.

We've made investments in Wealth Management this year in the form of hiring wealth advisors or we will be doing that to help us grow there. Capital markets has been a good growth rate for us, there's volatility in that business from time to time. They finished up well. We've talked earlier about that being a $200 million business. And that's where we finished for the year.

So I look at capital markets continuing to add a little bit of growth opportunities. Mortgage is the one that's a little bit more of a challenge. We perform a tad better than others because we're primarily a purchase shop versus a refi shop. Our production was down this quarter, but we are making investments there as well. Those investments are in mortgage loan originators that we'll strategically place in parts of our footprint that we think can give us additional growth there.

So the market value adjustments happen from time to time as you know, this fourth quarter was unusually noisy and we don't think recurs at least to that extent going forward.

Saul Martinez
Analyst, UBS Securities LLC

Q

Okay. So other than the market value adjustment, it's the – and the equity impact, it's steady as she goes, and seeing growth in your fee lines.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

[indiscernible] (00:31:26). Yeah.

Saul Martinez
Analyst, UBS Securities LLC

Q

Yeah. And capital, you've obviously drawn that, the CET1 down to 9.8% you've guided to 9.5%. Is the goal – is the idea still that you get to the 9.5% in 2019? And beyond that, how are you thinking about potentially maybe bringing that down further obviously with the regulatory backdrop NPR out there, is there scope to reduce your target CET1 beyond the 9.5%?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

We set the 9:5% based on how we view our risk profile, obviously starting with a 4.5% minimum threshold and adding in buffers and then looking at our risk, and that's where the 9.5% is. It didn't have anything to do with the regulatory regime in CCAR. So, hopefully we get a little bit of relief to manage our capital a little more freely than we have been which we would see as a big plus, so that we can optimize our capital and keep our capital at that 9.5% level.

Mathematically, given our risk that we have today, we could operate a little less than that, but we are choosing not to do so. We think that's the best thing for us. Give us a little bit of dry powder and be able to take advantage of opportunities to invest that in organic growth and just be prepared should anything happen. But we think that 9.5% is also a capital level that allows us to provide an appropriate risk adjusted return to our shareholders in the form of return on average tangible common equity that they expect. And so, we don't see taking that down.

Saul Martinez
Analyst, UBS Securities LLC
Q

Okay. And the buybacks in the first and second quarter obviously a bit lower, but like what's your projection of when you kind of get to that 9.5% now?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.
A

Yeah, it'll be towards the – it'll be towards the middle of the year. And of course, it's all dependent on loan growth. So we had pretty good loan growth in the fourth quarter that used up a little bit of the capital. And at the rate that we're going at, we could get there towards middle of the year.

Saul Martinez
Analyst, UBS Securities LLC
Q

Great. Thanks.

Operator: And your next question is from the line of John Pancari with Evercore ISI.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Good morning, John.

John Pancari
Analyst, Evercore Group LLC
Q

Good morning. I know you had indicated that the higher charge-offs in the quarter were some of the normalization of consumer and indirect consumer charge-offs. And I wanted to see if you can give a little bit – get a little bit more color on what exact areas within Consumer and indirect are you seeing that, that normalization and what are your expectations in terms of how that – those losses can trend through the year particularly in Consumer?

Barbara I. Godin
Senior Executive Vice President & Chief Credit Officer, Regions Financial Corp.
A

Yeah. This is Barb Godin. The normalization that we're seeing is really across all products. Residential mortgage is coming off some really low levels, running 4 basis points to 6 basis points of loss, which again is not normal. So that will raise just a little bit. Home equity is doing very well. Home equity will move up just a little bit. Indirect auto has been behaving well for us. So we see that holding pretty steady. Some of the third party relationships that we have, again, they are performing as expected. So where we're seeing the Consumer portfolio overall, we do see things as being pretty straightforward. And our indirect balances have gone up and that's created a little bit again, in terms of a little more marginal loss there. But all-in, credit feels really good where we are right now in this cycle.

John Pancari
Analyst, Evercore Group LLC

Q

Okay. That's helpful. And then my second one is also on credit. Two parts here. One, your delinquencies, early stage of delinquencies were up 21% this year or this quarter and some of that's Consumer and I get at the – but if commercial was up, so wanted to get some color on what drove that? And then separately, how you're thinking about the loan loss reserve overall here? You bled it by about 2 basis points on a reserve-to-loan ratio this quarter, so, what's your outlook there for the year? Thanks.

Barbara I. Godin
Senior Executive Vice President & Chief Credit Officer, Regions Financial Corp.

A

Yeah, let me start with the allowance here right, the – it came in at 1.01% which is down just a tad. A lot if that is due to loan growth. We think that allowance will probably hover right in that area. It might go down to 1% but I don't see it going sub 1% on the allowance. Relative to delinquencies, yeah, we did move up just a tad, one of that was a 30-day plus delinquency quite frankly was due to one large C&I credit that by the way repaid us immediately after – we made the payment immediately after the end of the month especially given the holidays etcetera, got caught up in the mail. So, that one's cleared.

So, again on the delinquency front, we see those as being generally stable. And again, we look at the consumer book where the delinquencies did go up a tad. Again, that seasonality we see that every fourth quarter. So, nothing there that we're concerned about.

John Pancari
Analyst, Evercore Group LLC

Q

Got it. All right, thanks, Barb.

Operator: Your next question is from the line of Betsy Graseck with Morgan Stanley.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning, Betsy.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Hi, good morning. Hi, good morning. Hey, a couple of questions. One, on deposit betas, I know you talked through how you've – it's been low relative to peers and also this quarter. Could you just give us a sense as to whether or not you think any of that was impacted by people moving from maybe market exposures to deposit exposures? Should we expect to see a little bit of a pickup in the first quarter? And if you could give us a sense as to whether or not there was any change in deposit betas on the Corporate versus the Consumer side this past quarter?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Yeah. I think, Betsy, you should expect that deposit betas continue to move up. We've continued to outperform our cumulative beta at 39%, it's in pretty good shape or 39% for the quarter, I'm sorry, cumulative of 22%. So, I think that we – you're going to see that continue to trickle up a bit. Some of that will be due to mix change as we think about Corporate betas – Corporate betas have moved up to about 81% from 72%. So, continue to see that increase a bit as expected and that's really been baked into our margin guidance all along.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thanks. And then just separately, I know you talked through the 9.5% on the CET1. I guess a couple of questions there. One, does it matter if you don't have to do the CCAR this year? Two, is there a triangulation that you're doing between CET1 and maybe other ratios like TC to TA or other ratios that the rating agencies have out there that you're thinking about that ends up with what looks to me like it might be a little bit on the high end of the range relative to your competitors and relative to the risk in your own book?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Well, we – everybody has to run their capital ratios based on their own risk profiles or what they perceived to be the risk. We think Common Equity Tier 1 are most expensive form of capital. It behooves us to optimize all of our capital elements but that one in particular given how expensive it is. As we move down closer to that 9.5%, we are solving a portion of our Tier 1 with common equity. So, we will have to backfill the Common Equity piece for Tier 1 with preferred stock. We've had that in our plan. We've talked about that before. That's something that will happen most likely in the middle of the year. We're evaluating how much of that and when we want to put that on. So there are a lot of moving parts there. But you're exactly right. We're going to have to bolster Tier 1, one for regulatory purposes, but also for rating agency purposes. And they know what our capital plan is, and they know what our optimization plan looks like.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

And then on the stress test, if you don't have to do that this year does that – I think it doesn't really matter?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

No. We do our own stress test anyway. We will have to fill out all the forms that are associated with it and maybe – this may be the year of the off cycle. But what we're really looking for and hope we get through the MPR is relieved to manage our capital real time. So we have espoused – as an example we've espoused a 9.5% limit where we want to be on common equity Tier 1.

If we could manage capital the way we want to, we would be there right now, we wouldn't have to wait for time. Because when we submit a capital plan, you have to execute dividend changes and share repurchases along the timeline that you provided in your plan which you filed a year before and things change. As things change, we need to be able to maneuver our capital appropriately. So hopefully we'll get that, but we'll have to see.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Perfect. Thank you.

Operator: Your next question is from Peter Winter with Wedbush Securities.

Peter J. Winter
Analyst, Wedbush Securities, Inc.

Q

Good morning.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Hi, Peter.

Peter J. Winter
Analyst, Wedbush Securities, Inc.

Q

I was wondering the net interest income outlook for 2019 is it fair to assume that it should grow at a similar pace to the loan growth?

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Given, and there are a lot other moving parts but in general – generally speaking that's accurate. As the balance – the balance sheet growth is, depending on what rates do, is going to be the bigger determinant of our growth and NII. We do think – as I mentioned earlier, we have a little bit of a tailwind with just asset reprice, fixed rate assets repricing this year $12 billion between securities and loans if we can pick up 30 basis points to 50 basis points in NII as they come through the pipe. So, – but yeah, I think it's going to be important for us to get appropriate balance sheet growth to continue to grow NII at the pace we want.

Peter J. Winter
Analyst, Wedbush Securities, Inc.

Q

Okay. And then just a big picture question with expenses, you guys over the years have done a very good job holding expenses flat and still investing in the business for a number of years. If we look beyond 2019, is there still levers to pull on the expense side or are you close to exhausting those?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

No, I think, Peter this is John, the whole purpose behind our Simplify and Grow initiative was the recognition that at some point we would quit benefiting from rising rates, we would quit benefiting from improving credit, and we would have to be operating more efficiently and effectively. We'd have to be operating in a way that will allow us to grow our business because we were easier to do business with.

And so, our commitment to continuous improvement is based upon the belief we can continue to find ways to be more efficient, effective to invest in our business whether it's hiring more bankers, spending money on technology, building some branches in markets. We've got to continue to grow our business through reinvestment, which we largely want to pay for through our effort to be more efficient and effective.

Peter J. Winter
Analyst, Wedbush Securities, Inc.

Q

Great. Thanks a lot.

Operator: Your next question is from Christopher Marinac with FIG Partners LLC.

Christopher William Marinac
Analyst, FIG Partners LLC

Q

Thanks, guys. I just wanted to ask Barb about CECL and her thoughts on how this play out the rest of the year, and to what extent you will disclose maybe in a couple of quarters how CECL looks for next year?

Barbara I. Godin
Senior Executive Vice President & Chief Credit Officer, Regions Financial Corp.

A

Yeah. We're doing a lot of work on CECL as our – all of our peer banks, we are in great shape as far as I'm concerned, we're about to start running parallel the old process and the new process. So not much to disclose there in terms of what the numbers look like. But again, feel good about the entire process and we're going to be ready for it.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yeah. I think we're in really good shape. We've committed to our board to report to them on a quarterly basis as to just how the parallel reporting manifests itself and what the impacts will be, and as Barb said, I think we're in really good shape and will be come January 1, 2020.

Christopher William Marinac
Analyst, FIG Partners LLC

Q

Sounds good. Thank you very much.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Thank you.

Operator: And your last question is from Gerard Cassidy with RBC.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Good morning, everyone.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning, Gerard.

David J. Turner, Jr.
Senior Executive Vice President & Chief Financial Officer, Regions Financial Corp.

A

Gerard.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

John, when you think about the risks to the Regions' earnings stream over the next year or two. Aside from a recession which we all know would bring on the credit provision risk. What do you worry about when you go home at night about your outlook for the company going forward?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Well, obviously first and foremost, we want to protect and continue to grow our core deposit base. And we think that's really the strength of our franchise. And I think we have demonstrated at least over the last 24 months or so, the power of that deposit franchise much of which wasn't being valued prior to rates beginning to rise. And so – but that would be first and foremost. We've got to continue to grow our businesses. And particularly, those core businesses. So demonstrating [ph] 1.3% or 1.4% (00:45:20) consumer checking account growth, growth in consumer demand deposits, growth in consumer savings, really again core to our business and to what I think makes our franchise valuable and allows us to build that consistently performing and sustainable bank.

And then, the other piece is credit. Are we focused on the credit risk appropriate in our business? Are we managing concentrations? Are we building diverse books of business? Do we understand the risks and are we effectively managing those and reacting to emerging risks quickly, and expeditiously, and effectively? Those are the things I think about when I think about what does it mean to be a good banker and how do you build consistently performing and sustainable bank.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Very good and this question I guess is directed at Barb, over the years, obviously you've had a good understanding of what the regulators are thinking about in terms of risks in the industry's portfolio as well as your own portfolio. We all remember the 2015-2016 time period with energy credits. Can you share with us when you talk to them today, what's their kind of focus in terms of worry on credit? And if you could also tie in, I apologize, if you've already addressed this, your leverage loan exposure and what you guys are doing in that area are as well?

Barbara I. Godin
Senior Executive Vice President & Chief Credit Officer, Regions Financial Corp.

A

Yeah. I think the regulators and us we're all in a good place. What's happening as you know in the industry is they're looking as we are looking at normalization and where does that go to, and over what period of time. So there's nothing in particular that they're really focused on. Like us, we're focused on, and you mentioned it, leverage loans. And let me just comment on that in general, I know David already did that our primary definition for leverage loans in the company is consistent with the interagency guidelines from 2013, that's 3 times senior, 4 times total committed debt-to-EBITDA that may or may not be fully secured by margin collateral. Of course there's some differing thresholds based on certain industries such as midstream wireless, towers etcetera, but we don't exclude borrowers from the leverage designation based on credit quality, on borrower ownership for the purpose of the financing. And we make this leverage lending determination at the time of any credit event such as refinancing, renewal acquisition, amendments, all that.

And as you know, I guess the difference is every institution has their own policy, quite frankly on how they call a loan leveraged. And so it gets a little difficult in terms of comparability. So, all in as I think about the leverage loan book we feel very good about this book. It's got strong underwriting. We have a dedicated team by the way, Gerard that's focused on these deals. And on top of that, we stress test these loans to ensure that they're going to perform at a downturn economy. So, all-in, yes leverage loans are right now on top of a lot of people's minds but we feel again really good about that book, it's a really strong, good, well-performing book.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Yeah, I would just to add, through our diverse, very diverse and spread across a number of industry groups largely aligned with our specialized industries, bankers, and their expertise. About 27% is sponsor owned and that's down from the mid-30s. So, as we think about risk and managing risk in the business, we've been exiting some relationships that we think are the most risky parts of that portfolio.

Gerard Cassidy
Analyst, RBC Capital Markets LLC
Q

If I could sneak just one last question on leverage loans. One of your peers announced earnings this week and pointed out that they had a pickup in their criticized loans.

And one of their individual credits was a borrower who went out in the non-bank market and obtained leveraged loans and it alarmed them so they put -they had a criticized loan. What techniques or what monitoring technology do you have or how do you figure out who of your good borrowers who don't have leverage loans with you but could actually go out and do something like that and then you guys have that indirect exposure?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

We're actively servicing those credits on a quarterly basis generally sometimes less frequently, sometimes more depending upon the risk in the particular credit relationship. And so as the credit profile or the risk profile changes, because the company takes on additional debt either in the bank environment or non-ban environment, we would pick that up as a risk factor and the consideration is how we think about credit.

Gerard Cassidy
Analyst, RBC Capital Markets LLC
Q

Great. Thank you again, guys.

Operator: Thank you. I would now like to turn the call back to John Turner for closing remarks.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

Okay. Well, that ends the call. Thank you all for your participation. Again, we're very pleased with our 2018 results and I think we have a very solid plan for 2019. And look forward to seeing all of you hope at our Investor Day on February 27. Thank you.

Operator: This does conclude today's conference call. You may now disconnect.